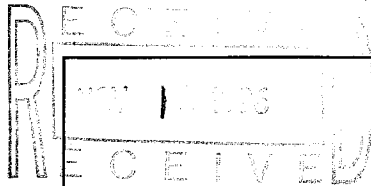


ORIGINAL



1 UTILITIES DEPARTMENT

TESTIMONY OF JOE MAREADY

2 FOR

3 POSTED 11/13/96
pad

4 THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

5 DOCKET NO. 96-168-W/S

6 PROPOSED RATE INCREASE

7 IN RE: KIAWAH ISLAND UTILITY, INC.

8 Q. WOULD YOU PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION?

9 A. My name is Joe Maready and I reside in Irmo, South
10 Carolina. I am employed by the South Carolina Public
11 Service Commission as a Public Utilities Accountant. My
12 business address is 111 Doctors Circle, Columbia, South
13 Carolina 29203.

14 Q. WOULD YOU PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND
15 YOUR EXPERIENCE?

16 A. I received a B. S. Degree in General Business from the
17 University of North Carolina at Chapel Hill and have
18 taken over thirty semester hours in Accounting at the
19 University of South Carolina. I was employed with this
20 Commission on August 12, 1970. Since that time, I have
21 testified in at least fifty-three (53) rate cases
22 involving electric, gas, telephone, water, sewer, radio
23 common carriers, general commodities, bus and household
24 goods companies.

25 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY INVOLVING KIAWAH

1 ISLAND UTILITY, INC.?

2 A. The purpose of my testimony is to present Staff's
3 findings and recommendations resulting from our review of
4 the books and records of the Company. The results are
5 set forth in the Commission Staff Report which includes
6 attached exhibits.

7 Q. IN CONNECTION WITH YOUR TESTIMONY, DID YOU PREPARE OR
8 CAUSE TO BE PREPARED CERTAIN EXHIBITS?

9 A. Yes, the Accounting Staff has prepared Exhibits A through
10 A-3 and they are included in the report.

11 Q. MR. CHAIRMAN, I WOULD LIKE TO MOVE ACCOUNTING EXHIBITS A
12 THROUGH A-3 INTO THE RECORD AT THIS TIME. MR. MAREADY,
13 WOULD YOU NOW EXPLAIN EXHIBIT A?

14 A. Yes. The Company's operating margins for the test year
15 ended December 31, 1995 are presented in Exhibit A.
16 The book balances for both water and sewer operations
17 were verified to the Company's records during the
18 examination by the Accounting Staff, with the exception
19 of customer growth, shown on Exhibit A-2. Operating
20 margin on total operations for the test year is 0.07%.
21 Accounting and pro forma adjustments were made to
22 normalize per book operations resulting in an operating
23 margin of (2.48%). The Company is proposing rates that
24 will produce total additional revenues of \$487,724 (See
25 Report of Utilities Department, Exhibit B, for the

1 proposed revenues). After the proposed increases are
2 added to the adjusted amounts, operating margin increases
3 to 8.57% on total operations. Also shown on lines 47-57
4 of this Exhibit is the Company's original cost rate base.

5 Q. WOULD YOU EXPLAIN THE ADJUSTMENTS IN EXHIBIT A-1 THAT YOU
6 CARRY FORWARD TO COLUMNS 2 AND 4 OF EXHIBIT A?

7 A. Exhibit A-1 includes adjustments proposed by both the
8 Accounting and Utilities Departments. This explanation
9 of Exhibit A-1 will address only those adjustments which
10 materially differ from the adjustments submitted by the
11 Company and are sponsored by the Accounting Department.
12 All numbers shown in parentheses are decreases while
13 numbers not in parentheses are increases. References to
14 Item Numbers are shown in the far left column of Exhibit
15 A-1.

16 Item No. 3, DHEC Recoupment Fees (\$7,774) and Item No.
17 10, DHEC pass-through expenses (\$7,091)

18 State law allows the utilities in South Carolina to pass
19 on to the customers, as a separate billing item,
20 inspections paid to the Department of Health and
21 Environmental Control (D.H.E.C.). Since these revenues
22 and expenses are not under the jurisdiction of this
23 Commission, Staff proposed that they be eliminated.

24 Item No. 7, Purchased Water, (\$2,288)

25 In August of the test year, John's Island Water Company,

1 the supplier of potable water to Kiawah, reassessed the
2 utility for prior administrative costs. A portion of the
3 retroactive costs covered three (3) months of 1994. Also
4 during the test year, the price of water per thousand
5 gallons increased from \$1.4240 to \$1.4639. Using the
6 gallons purchased during the test year and applying the
7 increased cost/thousand gallons resulted in a decrease in
8 the costs of potable water by \$2,288.

9 Item No. 8, Salaries Increase, \$47,736. Throughout the
10 Company's Application and Company responses to
11 interrogatories, there are references to upgrading the
12 employees' salaries by 13-14% during 1996. For the
13 two-week period ending October 16, 1996, employees were
14 granted pay increases of varying percentages. Staff
15 annualized the new wages for an increase, which includes
16 the employer's portion of Social Security costs, of
17 \$47,736. This procedure complies with previous decisions
18 of the Commission.

19 Item No. 9, Management Fees, (\$64,000).

20 In Kiawah's prior rate case, Docket Number 92-192-W/S,
21 Order Number 92-1030, dated December 15, 1992, the
22 Company's proposed Management Fee was discussed. At page
23 26, it states "This information was..... not supported by
24 time sheets". It further stated "In the future, if the
25 Company wishes to present similar information concerning

1 the allocation of such costs to the utility company, time
2 sheets and appropriate records should be maintained and
3 available for inspection". From the total verbiage of
4 the Order, Staff believes it is incumbent upon itself to
5 have the Company provide what information is available so
6 that Staff can better determine the value of the parent's
7 service to its utility subsidiary. Should the
8 information provided to Staff be inadequate, then a
9 portion or all of the fee is to be denied.

10 The Company provided Staff with time sheets of the
11 employees of the parent company but did not include time
12 sheets for the partners or the Board of Directors. Total
13 time accounted for was 525 hours. It is Staff's opinion
14 that the company has not proven the reasonableness of the
15 management fee of \$100,000. In Hilton Head Plantation
16 Utilities, Inc. vs. The Public Service Commission of
17 South Carolina, 312 S.C. 448, 441 S.E. 2d 32 (1994) the
18 court held that "the burden of proof of reasonableness of
19 expenses incurred.....rests with the utility".

20 Further, the Court held that when payments are made to an
21 affiliate, a mere showing of actual payment does not
22 establish a prima facie case of reasonableness. The
23 Court went on to say that allowance of charges arising
24 out of intracompany relationships may be properly refused
25 when there is an absence of data and information which

1 would allow the Commission to ascertain the reasonable
2 cost of such service. Hilton Head Plantation Utilities,
3 Inc. v. PSC, supra.

4 The utility further contends that the parent is
5 responsible for providing services for "Plant
6 Expansion/Capital additional analysis and review". (See
7 Item 5A of the Management Service Agreement dated January
8 1993). Staff does not object to the added responsibility
9 since the parent is responsible for the sale of land
10 throughout the island. However, the Chart of Accounts
11 for Water and Sewer Companies, adopted by this
12 Commission, at Accounting Instruction Number 20, clearly
13 defines these expenses as a cost of Construction and not
14 as an expense item.

15 Staff is of the opinion that the monthly management fee
16 of \$3,000 addressed and approved by this Commission in
17 the last order is appropriate. The difference in Staff's
18 annualized fee of \$36,000 and the annual fee on the
19 Company's books of \$100,000 results in a decrease of
20 \$64,000.

21 Item No. 12, Tank Painting, (\$28,676)

22 During the test year, the Company paid for its share of
23 painting the water tank on John's Island in the amount of
24 \$43,014. Considering the number of tanks necessary for
25 rendering service, including those within its own service

1 area, Staff feels this cost should be amortized over a
2 three-year period. Staff, then, removed two-thirds, or
3 \$28,676, of the painting expenses.

4 Item No. 13, Rate Case Expenses, \$4,224

5 The Company proposed to increase rate case expenses based
6 on the same amount allowed in the last case of \$10,826.
7 Staff is proposing the current amount through October 4,
8 1996. The Company will have the option at the hearing to
9 bring the expenses up to date if sufficient evidence is
10 presented for approval.

11 Item No. 14, Contributions Below-The-Line, (\$2,594)

12 Staff agrees with the contributions proposed by the
13 Company. During Staff's sample, Staff found additional
14 expenses for flowers to employees, Christmas party
15 expenses and other items amounting to \$719 that should
16 also be removed for ratemaking purposes.

17 Item No. 15, Consulting and Legal Fees, (\$13,579)

18 Staff's sample of expenses revealed the company incurred
19 consulting fees of \$6,502 and legal fees of \$13,867 for
20 hearings before this Commission regarding telemetry of
21 irrigation customers and the Eugenia Avenue Sewer
22 Project. Staff is of the opinion that these items should
23 be prorated over a three-year period similar to a rate
24 case expense. Two-thirds of the expense of \$20,368 has
25 been deleted from operating expenses.

1 Item No. 16, Amortize Legal Expenses and Related
2 Accounts (\$4,365)

3 During the test year, the Utility incurred legal fees of
4 \$6,547 related to the installation of devices in large
5 irrigation customers' systems in order to cut the water
6 off if the need arose -- such as for fire protection.
7 Staff believes these legal fees should be amortized over
8 a three year period.

9 No. 17, Engineering Expenses and related accounts,
10 (\$82,335)

11 In its adjustments, the Company proposed to include a
12 three-year average of \$54,454 for consulting fees, or a
13 reduction to per book expenses of \$46,790. During the
14 test year, the utility hired two engineering firms to
15 provide "Fire Protection" and "Water Model" engineering
16 services for the total system. Staff feels these
17 expenses should be capitalized rather than expensed.

18 Item No. 18, Income Taxes, (\$12,000)

19 During the year, the utility paid an estimated Federal
20 Income Tax of \$12,000. Since taxable income after
21 adjustments on Exhibit A is negative, Staff has
22 eliminated the total income tax expense. (Note, however,
23 that Income Taxes will be computed based on taxable income
24 arising from the 'Proposed Increase' as shown in Item
25 Number 31.)

1 Item No. 19, Legal fees for Law Suit (\$26,265)

2 During the test year the utility was sued for not
3 adequately providing fire protection after two houses
4 were burned. Staff feels it is incumbent upon the
5 utility to protect its assets to the advantage of the
6 Ratepayers as well as the Stockholders. However, Staff
7 is of the opinion that the legal expenses of \$26,265
8 should be deferred until the law suit is settled.

9 Item No. 20, Sludge Removal, \$0.00

10 Beginning in September 1996, the Company began removing
11 sludge from Holding Cell #2. Since the original contract
12 was \$50,000, the company has proposed the funds be
13 included in its Operation and Maintenance expense for the
14 test year. The sludge contained within the cell is an
15 accumulation over many years and would therefore be
16 unfair to the ratepayers to include the total amount in
17 one lump sum. Staff proposes to deny the adjustment by
18 the company amounting to \$50,000.

19 Item No. 21, Lease Rental, (\$33,000)

20 In July, 1995, the Utility entered into an agreement to
21 lease approximately 2.3 acres of land from its parent,
22 KRA L.P. for \$66,000 per annum. During the test period
23 the Utility paid the parent \$33,000 for one-half year's
24 rental. Since this contract has not been approved by
25 this Commission, Staff proposes the expense be denied.

1 Item No. 22, Annualized Depreciation, \$29,733

2 Staff annualized depreciation on plant in service as of
3 the end of the test year December 31, 1995. Even though
4 the Company did not propose this adjustment, Staff feels
5 that this is a standard adjustment that fully falls
6 within the realm of 'known and measurable' changes and
7 must be made.

8 Item No. 23, Plant Additions for 1995 and 1996,
9 \$2,625,517, Depreciation Expense, \$61,700 and Related
10 Accounts

11 Staff has, on occasions, accepted major additions beyond
12 the test year when such additions will have a severe
13 financial impact upon the financial integrity of the
14 utility. However, the additions must be completed and
15 'used and useful' in rendering service. (See, for
16 example, Piedmont Natural Gas Company.)

17 The company inadvertently omitted depreciation expense
18 from the adjustments but, however, added the amount to
19 the accumulated depreciation. The Company also included
20 a project called the Eugenia Avenue Extension but
21 construction in the amount of \$500,000 will not begin
22 until February 1997. Staff is of the opinion that this
23 project does not meet the standards for inclusion in
24 plant in service and the related accounts.

25 Item No. 25, 'Ocean Course Extension' (\$323,642)